RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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May 7, 1986 LETTER 938

THE PICTURE: As this is written neither I nor anyone else can fully gauge the scope and implications of the Russian nuclear disaster. The situation is a horror, and it could entail food, loans, world nuclear policy and, of course, nuclear policy in the US with particular reference to the US utility industry.

But I want to make one thing clear. Primary bull markets don't end on shocking news, regardless of the shape or the enormity of that news. Wars, earthquakes, Presidential heart attacks, bank failures, none of these spell "doom" for a bull market. Bull markets (like bear markets) die of exhaustion. I don't know what else I can say about this, but remember, excess and exhaustion will ultimately kill this bull--not shocking news, be it news from Russia, the US, China or anyplace else.

By the way, my feeling is that the Russian nuclear mess simply provided an over-bought market with an excuse to go down. I don't think the Russian nuclear situation really presents any bearish implications for the great majority of US stocks, with the possible exception of the nuclear utilities (but even here I think the worst of the prejudice against US nuclear plants has been discounted).

We're now at one of those interesting areas where the D-J Averages are in position to tell us how strong or weak this market is. In late-March the Industrials and Transports recorded bull market highs of 1821.72 and 830.84 respectively. A decline set in, and on April 7 Industrials closed at a low of 1735.51 while the Transports closed at 778.83. Make a note of those two critical points.

From the April 7 lows, a new rally began. On April 21 the Dow closed at a new bull market high of 1855.90. But the Transports FAILED to confirm (a confirmation would have entailed the Transports bettering 830.84).

It is early May, and the Averages have fallen away sharply from their recent highs. So it remains to be seen whether or not ONE or BOTH April 7 low points will be violated. Thus we have a non-confirmation at the highs to worry about, and we have the April 7 lows with which to gauge the power of the decline. As this is written, a goodly portion of the recent market euphoria has been erased, and instead we hear about the "normal 10% to 15% correction" and even talk about "the end of the whole upward move". But at this point it would be well to remember that this is a PRIMARY BULL MARKET, and under Dow Theory we always give the PREVAILING trend the full benefit of the doubt.

Incidentally, it is interesting to note that the current weakness in the market came very soon after the recent "buying stampede" ended (see Letter 936, page 1). The end of the third sensational buying stampede is not a guaranteed signal for major market trouble, but if history repeats (as I have outlined in previous Letters), there should be a period (often a prolonged period) of market uncertainty-- or more often of corrective action following the termination of a third buying stampede.

From another standpoint, this market was badly in need of a correction. The 200-day moving average of the Dow now stands at roughly 1500. At its recent high of 1855 the Dow was about 360 points or a fat 23% above its own moving average! This wide percentage spread constituted a STRAIN on the market and thus

April 25 DJIA 1835.57; PTI 2261; A-D Ratio -5.21
May 2 DJIA 1774.68; PTI 2253; A-D Ratio -6.21

corrective action should have been expected. By the way, the exact same thing can be said for my PTI (Primary Trend Index) which as you see by the page 2 chart, was (at its high) far above its 89-day moving average. But as you can also see, the PTI at present is still holding above its moving average . Therefore, the PTI remains bullish.

As for the A-D ratio (again see page 2 chart), the ratio is still holding slightly above its rising trendline. If the A-D ratio can continue to hold above the trendline it would be a huge plus for the market. Conversely, a breaking of the trendline would be added evidence that the secondary trend of the stock market has turned down (see Late Notes on page 6 for the final update on this section).

GUESSING AT THE END: The biggest game in the nation seems to be guessing when this great bull market will end. Obviously, each and every scenario is simply a guess, but then there are good guesses and there are bad (stupid) guesses.

Over the years, I have noticed one peculiar thing about markets. In a very subtle way, they often end as a mirror reflection of the way they began. If that thought has any validity, how would we apply it to the current bull market?

First, how did the great bull market begin? A new (and very good) book is entitled "The Wall Street Gurus" (written by Peter Brimelow, Random House, $19.95). In the book, my 1974 market call is described, and I include a few paragraphs from the book below.

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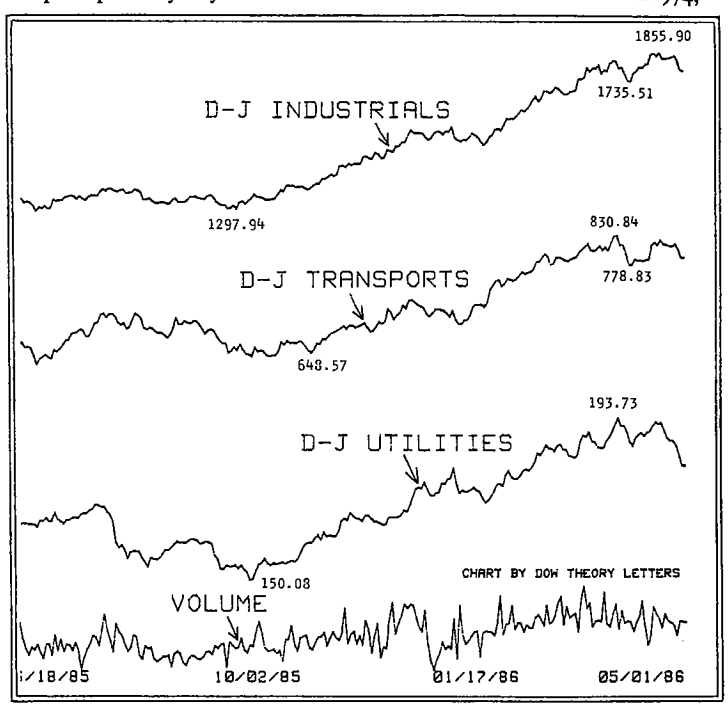
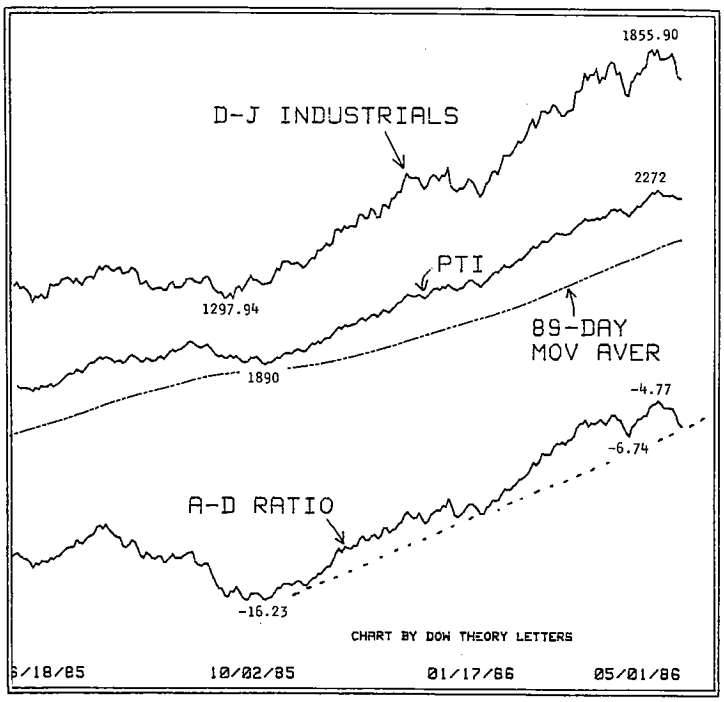
THE WALL STREET GURUS

though the Dow did struggle up to 1,067 in 1973, it then collapsed precipitously. By the time the Dow subsided below 600 in 1974,





many on Wall Street (and in Washington, in that Watergate year) were on the verge of real panic. The carnage among the smaller stocks not included in the Dow was even worse. On the American Stock Exchange, which specializes in junior companies, the average stock was down some 90 percent from the mid-1960 highs.

Conspicuously keeping his head amid all this was Richard Russell of the *Dow Theory Letters.* Russell had been unrelievedly bearish since 1966, and many people were beginning to think he had got stuck in that position. But on December 20, 1974, he put out a special issue announcing that, although on December 6 the Dow Industrials had broken through the previous low made in October and reached 577.6, the Dow Transportation Average had not made a new low, and therefore had not confirmed the bearish primary trend. The odds were better than fifty-fifty, Russell concluded, that the bear market was over. This turned out to be one of the outstanding calls of recent market history. The market rebounded fiercely in early 1975. On January 27 both the Dow Industrial and Transportation Averages surpassed the highs they had made in November, and Russell announced a Dow Theory confirmation of the bullish primary trend, noting that the sheer power of the advance and the simultaneous signal was unprecedented and that an epochal turning point had occurred. Within months the Dow was over 800. For the next several years, it was convalescent, working its way to the 1,000 level in 1976 and 1981 and the relapsing.

* *

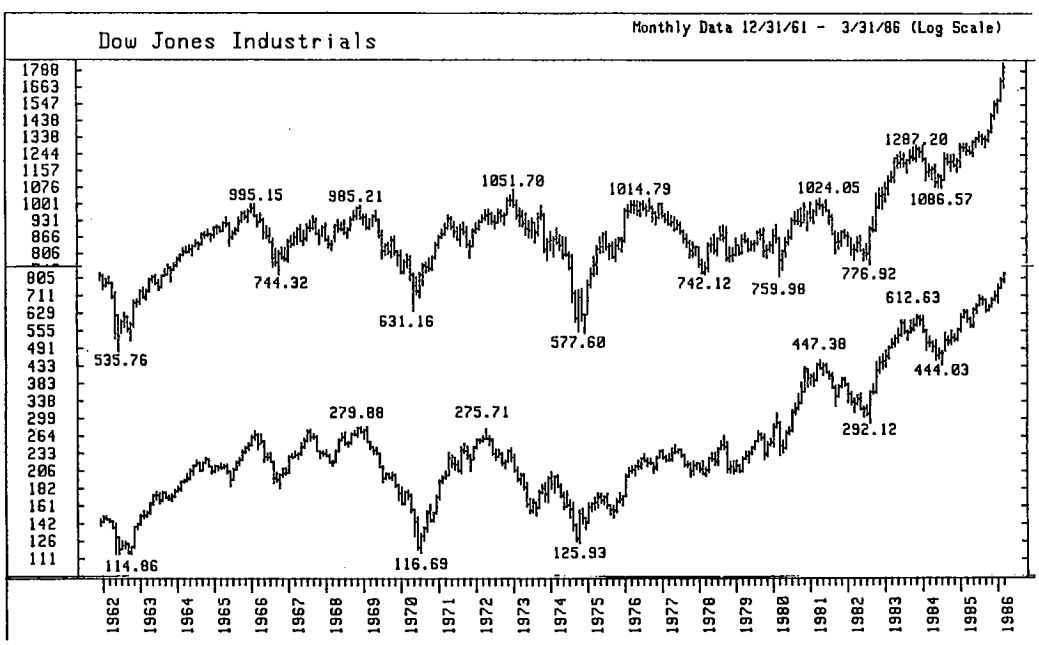
There were actually a great many items that went into my making that "turn of the tide" call. First, stocks had collapsed during 1973-74, and many high-grade issues were selling at great value. Yields on many Dow stocks were above 6% with some near 10%. Speculation had totally subsided, having been replaced by gloom, depression and an air of hopelessness.

In the midst of this despondency, the D-J Averages did a very remarkable thing, and I show this on the accompanying chart (chart courtesy of Ned Davis Research). Note that the 1970 low for the Industrials was 631.16, while the corresponding 1970 low for the Transports was 116.69. During that final plunge in 1974, the Dow (which everyone was watching) broke below its 1970 low of 631.16. It then broke below 600, frightening everyone to death, and continuing down to 577.60. Many leading analysts were then heard to predict Dow 400 and even 250, exactly the kind of prediction I expected to hear near the extreme bottom.

Now note that at the Dec. 6, 1974 low of 577.60, the Transports REFUSED TO CONFIRM in that they did not break below their own 1970 low of 116.69. Instead, the Transports halted their decline at 125.93. This was a dramatic, amazing non-confirmation. Intuitively, I felt that this action marked the EXTREME BOTTOM for the bear market -- and I said so. A few months later the actual Dow Theory signal for a new bull market was given. Skepticism was widespread, many analysts ridiculed my reports, and people called to tell me that I was crazy and that I would regret my rash prediction. But time proved my call correct, and a new bull market was born. The prices at the 1974 lows were never seen again.

All right, what has all this got to do with the market today? Here are a few of my guesses. (1) I would say that this bull market could well end as a mirror of the 1974 bear market. That means it should end in upside exhaustion, but with tremendous enthusiasm on the part of the public and the professionals. People should be as frothily optimistic near the end of this bull market as they were stonily pessimistic in late-1974.

(2) As far as the price structure, I would expect some sort of major non-confirmation to hint of the end of this bull market. What we could get might be a final spike peak, a sharp break in the Averages, then a big rally with one Average or the other recording a dramatic new high. That would be a major danger signal. The two Averages would then turn down and break their correction lows -- and the bear market would be on.



There will be a fooler in the picture, and the fooler may well be new highs in some of the widely-followed composite Averages such as the Value Line or the S&P 500. But the end, I believe, will be signaled by the venerable D-J Averages. And at a time when it will be popular to mouth that the Dow is "just a list of 30 big stocks" and therefore doesn't constitute "the real market."

INVESTMENT POSITION: People have just been far too complacent, and the current weakness (much of it brought on by news) will ultimately work to strengthen the bull market. But let's face it, the timing of this weakness is right on the button. Since 1965 there have only been four May-June periods (both months combined) when the market has advanced. Thus, there is a heavy seasonal bias for a May-June decline (conversely, if the market can hold up this May-June it is usually a sign of great strength).

I'll confess that I still like high-grade muni bonds here. On April 16 the yield on the S&P muni bond index stood ABOVE the yield on the S&P index of long-term government bonds. This has never happened before in history, and to me that means that muni tax-free yield is now a great bargain compared with almost anything else. By the way, most states don't allow you to avoid state taxes unless the muni bond is from YOUR OWN STATE, but 13 states (including Florida, Indiana, Texas, Vermont) do not tax ANY muni income regardless of the state it comes from (check your own state's rules). Many investors from high tax states don't realize the tax-saving bargains in muni income. For instance, in Calif., if you are in the 50% bracket, an 8% muni yield is worth 18% in taxable income. In NYC, an 8% muni yield is worth a fabulous 19.6% in taxable income.

American Brands, oft recommended here, has been a big winner and has about doubled since I first recommended it. The tobacco stocks are real cash generators, and I like RJR and MO. In time, I'm guessing that all the tobacco companies will be out or nearly out of the tobacco business. As I've suggested ever since Letter 934, I'm holding off on any new buying of stocks. I suggest that you do the same. One nice thing about the market--it's ALWAYS THERE.

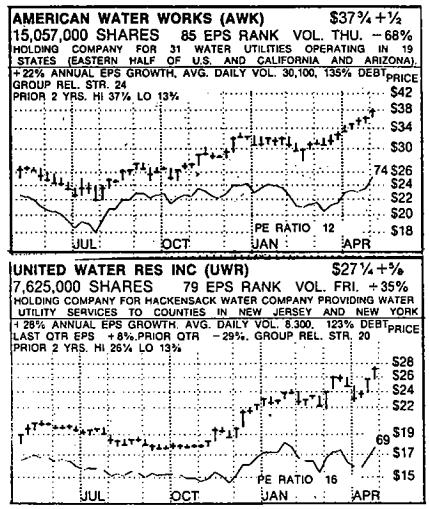
PREPARING: When I was a kid it was said that there were three great organizations in the world, the German army, the Catholic Church and Standard Oil Company of New Jersey (now known as Exxon). Times have changed. The German army was smashed during World War II. The Catholic Church is now in flux (to say the least) and financially it is running large deficits.

Exxon is still the largest oil company in the world. Exxon didn't retain its position by being stupid. Exxon's management is conceded by many to be one of the two or three best in the world. In the light of this, what Exxon is doing these days is well worth pondering (and I can't emphasize this too strongly).

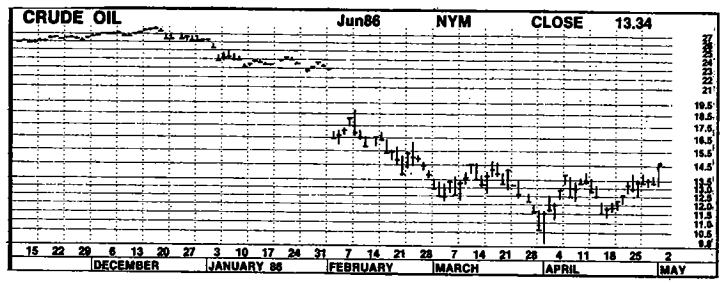
A few weeks ago Exxon called off a $3-billion North Sea oil program. That was interesting, but it didn't cause too much of a stir. Then on April 23 Exxon announced that despite a 37% boost in profits, it was offering early retirement (or early resignation with compensation) to more than 40,000 (over 25%) of its work force.

Wow! What is Exxon telling us. It tells me that the world's largest oil company and one of the world's best managements is getting ready for a long siege of hard times. The hard times may not start next week or even next year--but mighty Exxon sees it coming. And Exxon means to survive it, by (1) cutting expenses to the bone, (2) by diversification (they are already diversified), and (3) by being right possibly too soon.

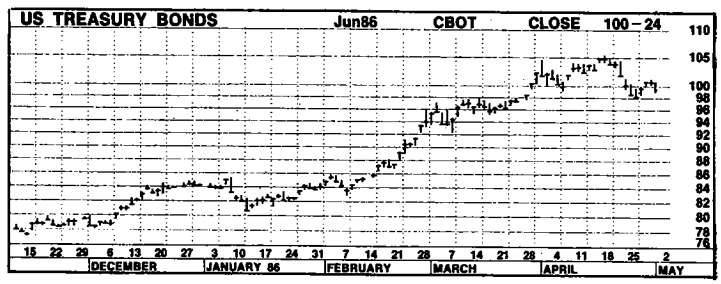
ASSORTED MARKET COMMENTS: What ever happened to the water stocks that I was recommending all last year? The answer is that they are doing well, and the fundamentals behind them have not changed. Water is still fated to be the scarcest commodity around -- and its price is still fated to go progressively higher (as those of you who examine your water bills probably are aware). Only two water stocks are listed on the NYSE, as shown on these two charts. Both AWK and UWR have been hitting new highs as these weekly charts attest (charts from Investor's Daily).



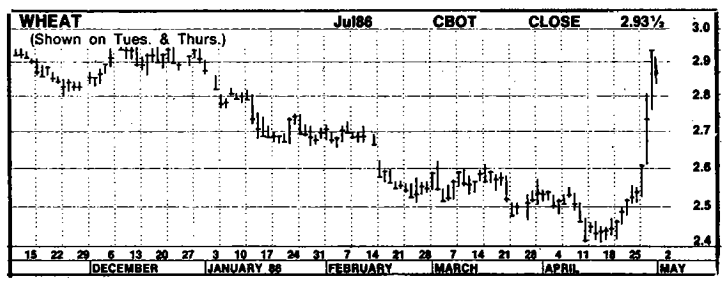
Crude oil (June futures) has formed a head-and-shoulders bottom pattern. This daily chart shows the collapse from the December $30 high down to the early-April break below 10. The important upside resistance comes in at 14.50, so I would say that any strong close above 15 (basis June) would constitute an important upside breakout. I think there's a good chance it's going to happen (conversely, a break down to 11 would be bearish -- and discouraging if you live in Texas or Oklahoma).



Bond buyers have been having a mixture of a picnic and an orgy. The good times may be close to ending--at least for a while. This chart of the June T-bond futures shows what could be a head-and-shoulders top in the bond with the important support at 98. A break below 98 on the June bonds would produce a well-defined top. If 98 is decisvely penetrated, I would look for the next support at 92.



One thing about the markets, they are cold, unemotional, and to the point. When the Russian crops around Kiev appeared to be contaminated, the commodity markets saw an opportunity to sell their heads off to the Ruskies. This chart (from Investor's Daily) shows you wheat wiping out the losses of months in a few days. It's an ill wind.....(pun intended.)



HISTORIC: For 28 years I have typed these reports on a rickety manual typewriter. For this stubborn adherence to custom I have been laughed at, reviled, even spit on. A few Letters back I lamented my fate at being probably the last manual typewriter-user in the nation. Lo, a few days later I received a letter from a subscriber who offered help and advice. This kind gentleman wrote, "Russell, you poor sap. Give yourself a break. I am 78 years old, and I have trashed my manual typewriter for a computer. Advice: sit down with a Macintosh, concentrate, have faith. In an hour you will be able to write."

The letter sounded convincing, and the timing was right. So Faye and I went to the nearest computer center, I sat down with a Macintosh, and in a few hours I was able to make it work (on a simple level). So I've done it! I've made the total leap from manual typewriter to computer--thereby completely bypassing the electric typewriter. I fed this Letter directly into the Mac, and good wife Faye (who's very computer minded) then edited it, and put the whole thing into a remarkable laser printer. Eureka! In 25% of the time the Letter was done. I've now made my peace with science, the computer age and the 20th century. Who says an old dog can't learn new tricks?

Swaps: For years Americans have been buying German appliances, Japanese cars, Swiss cutlery, French kitchen blenders. And what have we been using to pay for them? US paper, known as dollars. And that has been fine with the producers in Europe and Japan, because the value and purchasing power of the dollar was rising, and moreover, the dollars paid a fat rate of return. Then in 1985, the dollar rose to a spear-pointed top, and from that top came the collapse. Within a year the dollar was down better than 35% in terms of a basket of foreign currencies.

Two weeks ago the Fed cut the discount rate to 6.5%. The bond market sold off on the news. Then on April 22, Treasury bonds dropped the limit on the futures market. And the news was out. The Japanese were faltering in their buying of US debt.

Japanese buying US debt? That's right -- roughly 25% of all new Treasury debt is being purchased by the Japanese. If Japan halts its buying, the US is in trouble! Yes, it's come to that. The mighty US is now such a debt druggie, that it depends on foreigners to hold up the US Treasury. And what happens if foreigners stop buying the debt?

Somewhere ahead one of two things must happen. Either the US will cut back on its deficits and stop issuing billions upon billions of dollars worth of US bills, notes and bonds -- or we're going to face a bond market collapse as foreigners cease taking in US paper. As soon as that happens, interest rates will head up again, and the US economy will sink into recession.

It's the old story. Ultimately, the piper must be paid. In this case, the piper is our foreign creditors. Paper with rising purchasing power paying 10%, 12%, 14% is one thing, but paper falling in purchasing power and paying 7.25% -- that's quite another animal.

NOTES & QUOTES: Surprise: Japan is becoming the world's top banker. With the help of its sensationally positive balance-of-payments position, Japan is now exporting money by the carload. The net capital outflow from Japan in 1983 was $17.7 billion. That figure boomed to $50 billion in 1984, and the total rocketed to $65 billion in 1985. The money is now going overseas at the rate of $7 billion a month! Give Japan enough time and she'll own the world. It's the old story--wealth and power go to the nation that works hardest, is most competitive and sells the most. How does the US compete? By moving its manufacturing plants overseas or by joining up with Japanese companies. That's good for stockholders, but it's death for US workers. Moral: don't be an American worker, be an American stockholder!

* *

If GM offers you a directorship, don't turn it down too quickly. GM directors get a new GM car every three months or every 3,000 miles! Now that isn't hard to take, unless you're a confirmed Ferrari nut.

* *

Being a top athletic star is one road to riches these days. Bo Jackson, No. 1 NFL draft pick, has to decide whether he is going to opt for professional football or baseball. His probable asking price as a football player--$1.3 million a year (but don't forget, the average life of an NFL player is 4.5 years, while their baseball counterparts usually last much longer).

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Question: What stocks would I buy NOW if I had to make a few picks? I would take the following as a package: Interstate Power, Northeast Utilities, Southern Calif. Edison, JP Morgan, Security Pacific. I picked all of these based on earnings ability and value.

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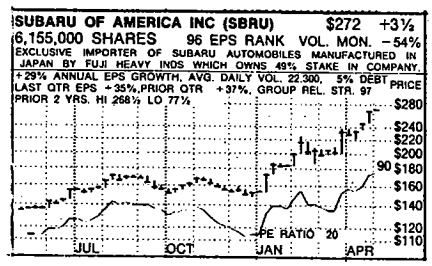
Subaru of America has been a very hot stock, rising from a 1985 low of 113 to a recent high of 272. Subaru is the US distributing company for Fuji Heavy Industries, the company that actually makes the car (how many Subaru owners know that?). We have a Subaru (the little two-door model), and it is one terrific car. Faye shopped many of the medium-priced cars and she was annoyed by the cheap accoutrements. For instance, neither the Honda Accura nor the Nissan Maxima had any woodwork on the dash; instead they were decorated with plastic, lots of it.



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I read the Stockman pieces in two consecutive issues of Newsweek. And I watched the Stockman interview on TV. They both had the ring of truth about them. Stockman makes the Reagan White House look like a three-ring circus, and an incompetent circus at that. The villain of the Stockman piece is Don Regan. Stockman states that Regan kept spinnning fairy tales for the President, pap-feeding him with what he wanted to hear. All and all, it's a very depressing view of Washington.

President Reagan naturally resented the whole Stockman treatment, and his reaction was one of aloofness. Asked about the book, Reagan replied, "I don't read fiction." So be it.

* *

Meanwhile, the nation goes on day-dreaming about the federal debt. Gramm-Rudman seeks to cut the deficit by $190 billion by 1990. Wonderful, except that deficits are still piling up, and this chart indicates that by 1990 the total debt will be $3.2 trillion, and the interest on the debt will be $252 billion! What to do? Make massive cuts NOW, and I mean massive. Federal spending would have to be reduced 22% in order to balance the '85 budget, and that's roughly what I think ought to happen. Or if the 22% is refused, then reduce spending 12% and raise the missing 10% with a national sales tax. I would opt to cut out the deficit IMMEDIATELY and COMPLETELY. That way the nation's debt situation would at last stand still. What people don't realize is that today the debt is getting worse, and the politicians are simply talking about reducing the RATE of growth in the deficit. Ultimately, this policy must lead to disaster; it's simply a matter of time.

* *

Speaking of disaster, that's roughly what has happened to "tax reform." The whole thing became a greedy pork-barrel mess, so much so that Senate Finance Committee Chairman Packwood first took the Committee private, then came out with a whole new idea, then disowned his new plan. Tax reform-- it looks like an idea whose time came--and went.

Say what you want about Richard Nixon, in my opinion he's as intelligent and shrewd as they come. He recently spoke before the American Newspaper Publishers Association. Here are a few excerpts from his speech:

QUESTION: Congress seems unable to deal with the critical challenges facing the country. Why and what can be done about it?

NIXON: With regard to Congress, let me address what has been a controversial subject, the Gramm-Rudman Act. It is brilliant short-term policy, and disastrous long-term policy. What it should be called is the Incumbents' Protection Bill of 1986, because the purpose of the bill is to keep the Congressmen from having to vote on these things.

QUESTION: Two years ago, you gave the American Society of Newspaper Editors your political forecast for the 1984 election, and it was extremely accurate. Can you give us an update?

NIXON: In 1986, assuming the economy stays about as good as it is, Republicans will lose 14 seats in the House. Mostly from the farm and energy areas that are depressed. As far as the Senate is concerned, the Republicans will hold the Senate and **Vice President Bush** is going to have to be there to break a tie. It will be 50-50, which means the vice president is going to be tied down a great deal during that critical two-year period. In 1988, if the economy is good, George Bush will be nominated and elected, because people will want to continue the policies that brought them where they are. If the economy happens to slide, Democrats will have a chance even to win the election.

On the Republican candidates, it's a wide open race. **Bush** is the best-qualified, (Jack) **Kemp** is the most charismatic, (Robert) **Dole** is the smartest, (Howard) **Baker** is the shrewdest, **(Alexander) Haig** is the strongest, and **Pat Robertson** is the best communicator.

Now, let's turn to the Democrats. **Gary Hart** is the frontrunner. Gary Hart is a formidable man. He's a very impressive man, he's a very thoughtful man. I think his problem is he's too cerebral to be a good Democratic candidate. To be a good Democratic candidate, you have to appeal to the heart, not the head. He'd be a better Republican candidate. But I'm not writing him off. He may not find the beef, but he might come up with a Whopper.

Lee Iacocca — I do not know him. Mrs. Nixon — Pat — is a very good judge. She said he is very effective. His problem is the same that plagued two other men who were rivals, Taft and Dewey: They couldn't tolerate fools. And that is very dangerous thing for politicians. (laughter). First, because there are so many fools. Second, some you think are fools may not be.

* *

What are the five stocks with the best dividend increase records on the NYSE? They are Central Southwest, Texas Utilities, Minnesota Power, FPL Group and Winn-Dixie. The first four are utility stocks. Central Southwest has 35 consecutive years of dividend increases, but its record is bettered by all four of the others. Winn-Dixie is a food chain.

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James Henry, in a recent issue of New Republic, claims that a large percentage of the US loans to South America has been siphoned off by the wealthy and leaders of the various countries. David Felix of Washington University (writing in Challenge magazine) estimates that total S. American assets in the US are around $180 billion. What it amounts to is a massive rip-off of US loans by powerful S. American investors.

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Comment of the month: President Reagan was asked his opinion of Bishop Tutu. Said Mr. Reagan, "So, so."

* *

Today, on the way to work, I saw a garbage pail piled to the brim with kindling wood and assorted scrap wood. That sight made me think of a PBS program on "Food in China" which I watched a few weeks ago. The origin of the wok was discussed, and I was most interested to see that wok cooking was a direct outgrowth of the fuel shortage in China. The film showed a Chinese family carefully breaking a single piece of wood and carefully placing it in a little stove. A large wok was placed on the stove, a little oil was added, and then a fish was placed in the wok along with a collection of vegetables. Five minutes of intense heat and the whole dinner was ready.

The kindling fire was then put out, and the valuable wood was saved. It was then explained that the wok heated very rapidly, particularly with hot oil, and that the whole idea was to cook everything together in the fastest possible time with the greatest economy of fuel (wood). No four or five burners were used, no half hour of cooking was involved. Here was economy of cooking in the extreme. And I thought of that garbage pail of kindling about to be trashed. It would have been fuel for 50 Chinese family dinners. And I wondered whether some day the people of the US might learn to be (or be forced to be) SAVERS. And I guess that I, a child of the Great Depression, would be at home in that kind of environment (yeah, I still yell at my kids when they forget to turn out the lights or when they leave the faucet dripping).

* *

Here we are, our Depressing Story of the week (if you're a lawyer, change depressing to happy).

> NEW YORK — Injury awards on liability claims total between $20 billion and $25 billion a year, a study by the Rand Corp.'s Institute for Civil Justice showed.
>
> And while multimillion-dollar awards made up only about 4% of the total number of cases in the 1980-85 period, the money value of these awards consumed nearly two-thirds of the total in all product liability cases, the study found.

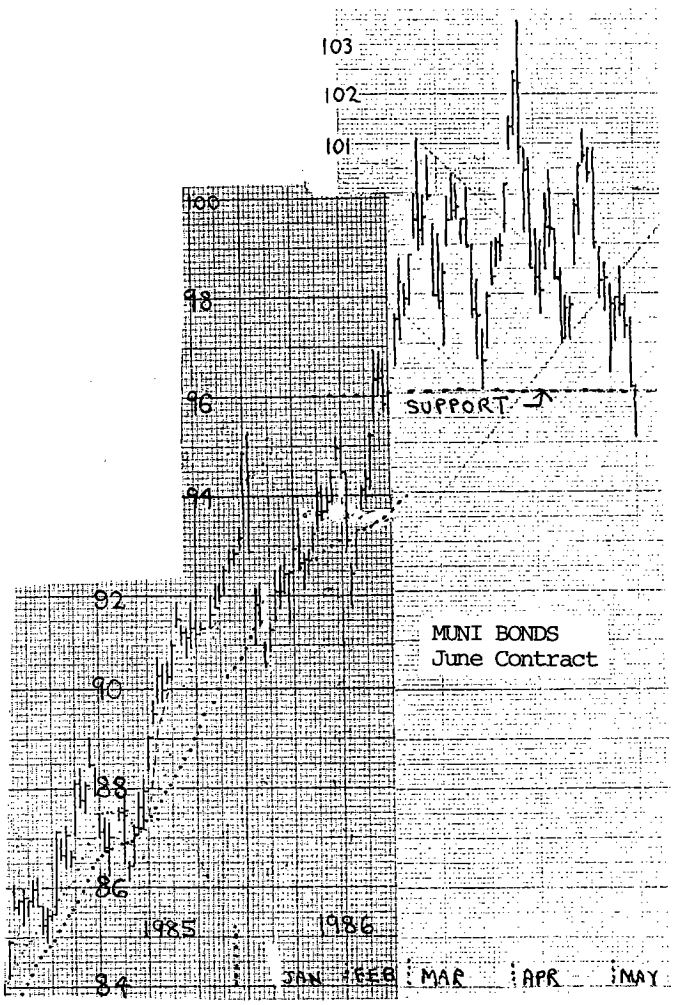
SMASH: How have commodities fared in the deflationary 1980 to '86 period? This list from R.E. McMasters' "The Reaper" gives you some idea of the smash. For silver and sugar it's been 1929. For the rest of the commods it's been poor to rotten. Commodity traders continue to hope and pray for the next bull market. And it bothers me that so blasted many people are now in the "beat the commodity markets" game. Consequently, the commodity markets may provide them with one long wait. Remember, I believe the operative word for the rest of the 1980s is going to be INCOME, not speculation. Of course, I could be wrong.

	Inflation Highs	Current	% Decline
Coffee	338	253	-25%
Live Cattle	80	59	-26%
Hogs	65	45	-31%
Feeder Cattle	95	62	-35%
Cotton	99	62	-37%
Lumber	285	178	-38%
Corn	400	233	-42%
Pork Bellies	105	59	-44%
Orange Juice	190	92	-52%
Wheat	640	300	-53%
Copper	145	65	-55%
Soybeans	1300	534	-59%
Crude Oil	32	13	-59%
Gold	875	343	-61%
T-Bill Yields	17%	6.5%	-62%
Soybean Meal	450	158	-65%
Soybean Oil	52	18	-65%
Silver	50	6	-88%
Sugar	66	7	-89%

BONDS, RATES: If there are any hints of coming inflation I sure don't see them. True, the chart of crude oil (see page 3 chart) suggests a potential upside breakout for oil, but that would not necessarily point to inflation (oil can go up for a lot of reasons other than inflation). But stronger oil would, I believe, most definitely discourage the bond market.

Besides oil, there is the problem of the huge US debt financing (with the biggest financing in history coming up very soon) plus the pathetic Congressional "efforts" to come up with a decent budget (decent meaning one that actually cuts the deficit).

At any rate, this is my chart of the municipal bond contract (basis June). As you can see the muni bonds have etched out what appears to be a good sized top with a peak just over 103 and the main support at 96. I have been watching this structure develop, and I have been hoping that it was just a big consolidation pattern. We'll see. On May 2 the June bonds plunged below the 96 support--but suprise--the bonds closed up for the day. If 96 is broken decisively, I would expect the bonds to drop to the 92-90 support level. The bond picture is certainly "toppy" looking, but in this business you never know--until it actually happens!

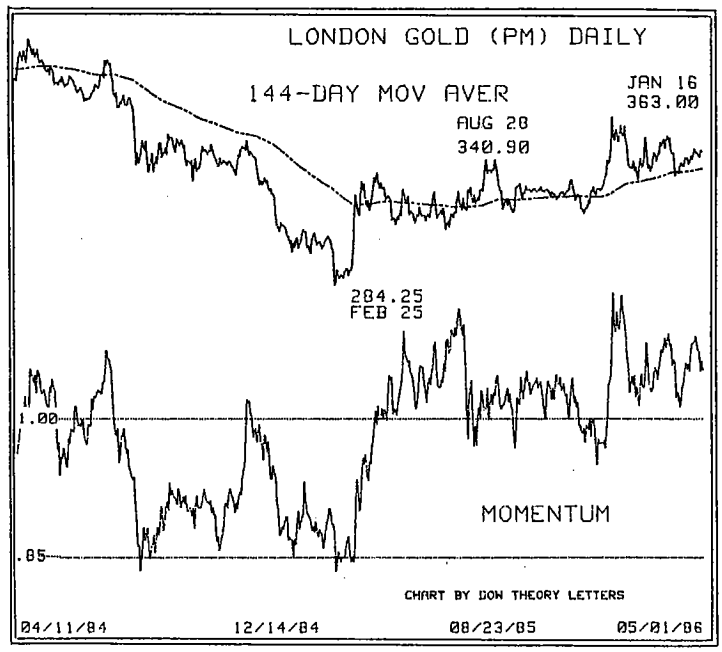


What do you do here if you are a bond holder? If you are a trader (and I'm not), you should probably take some profits. However, if you have been buying the bonds for income (and a great many of my subscribers have been doing just that) then you reinvest your income as bonds drop lower and rates rise. A lot of people have complained that they missed the big bond rallies that began in 1982 and again in 1984. Well, there's a good chance that you'll get another shot at the bond market (along with attractive rates) before 1986 is out.

Of course, there are a few other reasons why we could get a good bond sell-off from this area. The first is that I don't think many people are expecting interest rates (at least long-term rates) to rise from here. And as readers know, the markets love to confound and frustrate the public. The second reason why we could have lower bond prices is that this bond rise has really had no major correction since it began in mid-1984. But every market movement in history is eventually subject to a correction, and the 1984-86 bond boom will be no exception. It's just a question of when, and my feeling (based on this chart) is that "when" will be soon.

GOLD: There is't anything very new or exciting that I can say about gold here. The rumor is that the Russians will sell some of their gold in order to buy grains (based on the thesis that nuclear contamination may have wiped out a good deal of the Ukranian crop). Maybe so, maybe not.

My gold chart shows gold still holding above its 144-day moving average, and technicallly that's bullish. Gold momentum (89-day rate-of-change) is still holding above 1.00, and that too is technically bullish. Meanwhile the gold shares look bearish, and most of the other metals are no great shakes. Even copper (which is more of an industrial metal) looks poor on the charts. My guess is that gold is not in its present positive mode for reasons of inflation. No, I believe gold is holding because large interests have doubts about domestic and international debt and the various banking



systems. It never hurts to diversify-- particularly when the world is drowning in debt (and even more particularly when deflationary forces are in the saddle).

Late Notes: I'm reading all sorts and varieties of formulas, barometers, gauges, gimmicks, from "experts" offering opinions as to whether this market is in trouble. Most of these opinions aren't worth the paper they're written on. What I do want to emphasize is this--watch those two points on the Averages, namely Dow 1735.51 and on the Transports 778.83. The ability or inability of the Averages to hold above those points will tell the real story. And actually, a downside non-confirmation would be healthy here (i.e., one Average violating its low while the other holds stubbornly above its corresponding low). By the way, considering the non-confirmation at the highs, we're not seeing much downside pressure. Remember, if the market won't go down--then it wants to go up.

Watch for a surprise -- which would be the June crude oil contract rallying to 15 and moving out from there.

NEXT MAILING: May 21